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No. 94-840

In The

Supreme Court of the United States

October Term, 1994

BENJAMIN B. ALARID, *et al.*,

Petitioners,

v.

SECRETARY OF THE NEW MEXICO DEPARTMENT OF TAXATION AND REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The New Mexico Court Of Appeals

REPLY TO BRIEF IN OPPOSITION

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15 pp

QUESTIONS PRESENTED FOR REVIEW

1. Does the intergovernmental tax immunity doctrine apply as between the several states so as to render constitutionally invalid a state income tax that discriminates against another sovereign state or those with whom it deals?

2. Is the application by the New Mexico Court of Appeals of the "legal incidence" principle of the intergovernmental tax immunity doctrine, articulated in *United States v. New Mexico*, 455 U.S. 720, 735, n. 11, 102 S.Ct. 1373, 1383, n. 11, 71 L.Ed.2d 580 (1982), in conflict with the "nondiscrimination" component of the intergovernmental tax immunity doctrine applied by this Court in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 815, n. 4, 109 S.Ct. 1500, 1507, n. 4, 103 L.Ed.2d 891 (1989)?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED FOR REVIEW i

TABLE OF CONTENTS ii

TABLE OF CASES AND AUTHORITIES iii

RESPONSE TO POINT ONE 1

RESPONSE TO POINT TWO 8

TABLE OF CASES AND AUTHORITIES

Page

CASES

Decisions of the United States Supreme Court

Bonaparte v. Tax Court, 104 U.S. 592, 26 L.Ed. 845 (1881) 7

Davis v. Michigan Dept. of Treasury, 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989) ..... *passim*

Massachusetts v. United States, 435 U.S. 444, 98 S.Ct. 1153, 55 L.Ed.2d 403 (1978) 2

Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 103 S.Ct. 692, 74 L.Ed.2d 562 (1983) 2

Nevada v. Hall, 440 U.S. 410, 99 S.Ct. 1182, 59 L.Ed.2d 416 (1979) 1, 3, 6, 7

Phillips Chemical Co. v. Dumas Ind. Sch. Dist., 361 U.S. 376, 80 S.Ct. 474, 4 L.Ed.2d 384 (1960) 4, 5

South Carolina v. Baker, 485 U.S. 505, 108 S.Ct. 1355, 99 L.Ed.2d 592 (1988) 2, 5, 6, 8

State of Georgia v. City of Chattanooga, 264 U.S. 472, 44 S.Ct. 369, 68 L.Ed. 796 (1924) 7

U.S. v. California, ___ U.S. ___, 113 S.Ct. 1784, 123 L.Ed.2d 528 (1993) 8

United States v. County of Fresno, 429 U.S. 452, 97 S.Ct. 699, 50 L.Ed.2d 683 (1977) 4

United States v. New Mexico, 455 U.S. 720, 102 S.Ct. 1373, 71 L.Ed.2d 580 (1982) 8

TABLE OF CASES AND AUTHORITIES – Continued

Page

Decisions From Other Jurisdictions

Kansas v. Holcomb, 116 P. 251 (Kan. 1911) 7

Minnesota v. City of Hudson, 42 N.W.2d 546 (Minn. 1950) 7

Simpson v. Department of Revenue, 318 Or. 579, 870 P.3d 824, *cert. denied*, 115 S.Ct. 189 (1994) 6

Simpson v. Department of Revenue, 12 Or. Tax 455 (Or. Tax. Ct. 1993) 6

Warren County, Mississippi v. Hester, 54 So.2d 12 (La. 1951) 7

MISCELLANEOUS:

WEST'S ANN. CAL. GOV. CODE § 15379 3

RESPONSE TO POINT ONE

In responding to the conflicting decisions in the state courts on the question whether the Intergovernmental Tax Immunity doctrine ("ITI doctrine") operates to protect the governmental functions of one sovereign state from ***discriminatory*** taxation by another, the Brief in Opposition approaches the problem by posing a corresponding question: Is there a need for one sovereign state to protect its governmental functions from the taxing power of another state?[1] No federal decision has addressed these intergovernmental tax immunity issues.

In *Nevada v. Hall*, 440 U.S. 410, 99 S.Ct. 1182, 59 L.Ed. 2d 416 (1979), this Court held that the common law doctrine of sovereign immunity has no federal constitutional source. The Court was very careful, however, to confine its holding to torts arising from traffic accidents committed outside the defendant state, and perhaps even to traffic "policies." *See Nevada v. Hall*, 440 U.S. at 429 (Blackmun, J., dissenting). By its footnote 24, this Court observed that some state policies in another case may require a different result.[2] This is such a case, and

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[1] The Brief in Opposition and the decision in the Court below rely on the central premise that "neither California nor New Mexico had the ability to affect the other's governmental functions 'by reaching out to tax those functions' in the other state. Absent the need for one sovereign to protect itself from the taxing power of another, 'there is no basis on which to apply the ITI doctrine.' " (Brief in Opposition, at 5).

[2] The Court states:

> Suits involving traffic accidents occurring outside Nevada could hardly interfere with Nevada's capacity to fulfill its own sovereign responsibilities. We have no occasion, in this case, to consider whether different state policies, either of California or of Nevada, might require a different analysis or a different result.

440 U.S. at 424, n. 24.

discriminatory taxation of another state or those with whom it deals is a state policy which requires a different analysis and result.

In determining whether the constitutional issues presented in this case merit review by the Court, it must be recognized that unlike the common law concept of sovereign immunity, intergovernmental tax immunity has had a constitutional basis for nearly two hundred years. *See, South Carolina v. Baker,* 485 U.S. 505, 516-523, 108 S.Ct. 1355, 1362-1367, 99 L.Ed.2d 592 (1988); *Massachusetts v. United States,* 435 U.S. 444, 454-461, 98 S.Ct. 1153, 1160-1164, 55 L.Ed.2d 403 (1978). As applied to the taxation of a sovereign state or those with whom it deals, "state tax immunity" is implied from the States' role in the constitutional scheme.

> [T]he states had been in existence as independent sovereigns when the Constitution was adopted, and . . . the Constitution presupposes and guarantees the continued existence of the States as governmental bodies performing traditional sovereign functions.
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> * * *
>
> *Collector v. Day,* like the earlier *McCulloch v. Maryland,* reflected the view that the awesomeness of the taxing power required a flat and absolute prohibition against a tax implicating an essential state function because the ability of the federal courts to determine whether particular revenue measures would or would not destroy such an essential function was to be doubted.

Massachusetts v. United States, 435 U.S. at 455-456.

While the contours of the ITI doctrine have narrowed considerably over the past century and a half, one central tenet of the doctrine remains steadfastly unchanged from its inception: state and federal taxes are constitutionally invalid if they ***discriminate*** against a sovereign government or those with whom it deals. *See, Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 397, n. 7, 103 S.Ct. 692,

696, n. 7, 74 L.Ed.2d 562 (1983). Whether the nondiscrimination principle of the ITI doctrine applies between the several states clearly should depend upon whether the constitutional ***purpose*** of the doctrine is served by such application. That purpose is to protect one sovereign's governmental operations from undue interference by another. *Davis v. Michigan*, 489 U.S. 803, 814, 109 S.Ct. 1500, 1507, 103 L.Ed.2d 891 (1989).

What the arguments in the Brief in Opposition overlook in this case is that for fifty years the State of California has carried on extensive state governmental operations in New Mexico in performing scientific research, technological development and educational services at the Los Alamos National Laboratories ("LANL") under a contract with the United States government.[3] By virtue of this long and continuing relationship, the states of New Mexico and California have for decades competed for employees among residents of New Mexico in staffing their respective governmental operations. In like manner

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[3] It is important to observe with respect to these state governmental functions that this Court in *Nevada v. Hall* declined to adopt the global position taken by the lower court in that case that "state sovereignty ends at the state boundary." See, *Nevada v. Hall*, 440 U.S. at 428 (Blackmun, J., dissenting). As footnote 24 in *Nevada v. Hall* suggests, it is not inconceivable that a state in this day and age would carry on governmental functions outside of its territorial boundaries to which some aspect of sovereignty should properly attach. In this case, for example, California's governmental interests in operating the Los Alamos National Laboratory in New Mexico are identical to its governmental interests in operating two other national laboratories and several other technical research centers in California. See West's Ann. Cal. Gov. Code § 15379 (a legislative declaration that California make use of its universities and national laboratories for solutions to technical problems in order to retain California's industrial competitiveness and make the resources of its universities and national laboratories available to private industry and ultimately into the marketplace).

the State of New Mexico and the United States government compete for employees among the residents of New Mexico in conducting their respective governmental functions. These corresponding relationships take on significance in this case when the ***purpose*** of the ITI doctrine is focused and the rationale of *Davis v. Michigan* is applied.

The decisions of this Court have long recognized that ***discriminatory*** state taxes on the employees of another government, if left constitutionally unrestricted, can be escalated to adversely impact the operations of the other government.

> A tax on the income of federal employees, . . . if imposed only on them, could be escalated by a State so as to destroy the federal function performed by them either by making the Federal Government unable to hire anyone or by causing the Federal Government to pay prohibitively high salaries. This danger would never arise, however, if the tax is also imposed on the income . . . of all other residents and voters of the State.

United States v. County of Fresno, 429 U.S. 452, 463, n. 11, 97 S.Ct. 699, 705, n. 11, 50 L.Ed.2d 683 (1977).

The discriminatory tax exemption challenged in this case was an attempt by New Mexico to lower its governmental employment costs at the expense of taxpayers who were not granted the same exemption and who were therefore required to make up the difference. *See Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 384, 80 S.Ct. 474, 479, 4 L.Ed.2d 384 (1960). Those taxpayers included, among others, retirees of the federal government and retirees of the State of California who had worked at the Los Alamos National Laboratory throughout their careers. Like the ***discriminatory*** tax described above by this Court in *County of Fresno*, the New Mexico tax carried with it the prohibited potential to impair the governmental functions of another sovereign government whose employees were subject to the tax.

This same potential to impair governmental functions prompted this Court to strike down an identical discriminatory income tax in *Davis* because it discriminated against retirees of the federal government. There, as here, the taxing state was subsidizing its employment costs at the expense of unfavored taxpayers, including federal retirees. The Court held that "[t]axes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar." *Davis*, 489 U.S. at 815, n. 4.

The same rationale applies to the impact of the New Mexico tax upon the governmental operations of the State of California in New Mexico. California pays the retirement benefits that are the subject of the discriminatory tax. A state may not single out those who deal with another government for a tax burden that is not equally imposed on similarly situated taxpayers with whom the taxing state deals. *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. at 383. Left unchecked by the Constitution, New Mexico's discriminatory tax presents the potential of impairing California's (and the federal government's) ability to hire employees in New Mexico or requiring California (and the federal government) to pay prohibitively high salaries for performing their respective governmental functions.[4] These are the very concerns the ITI doctrine was designed to allay. *Davis*.

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[4] The scope and magnitude of the potential impairment of governmental functions is ***immaterial*** under the ITI doctrine. As explained in *South Carolina v. Baker*,

> [We] disagree with Justice O'Connor's apparent assumption [in her dissenting opinion] that if this court does not undertake the open-ended and administratively daunting inquiry required by her ["substantial" adverse affect] test, we leave States at the mercy of a congressional power to destroy them via excessive taxation. . . . The nondiscrimination principle at the heart of modern intergovernmental tax

The cases cited in the Brief in Opposition either present a different factual setting, do not involve discriminatory state policies or do not address the application or rationale of the ITI doctrine. They do not answer any of the unique issues presented for review and decision in this case.

In *Simpson v. Department of Revenue*, 318 Or. 579, 870 P.2d 824, cert. denied, 115 S.Ct. 189 (1994), the lower tax court opinion reflects that the ***only*** relationship between the taxing state (Oregon) and the state alleged to be protected by the ITI doctrine (Alaska) was that the retiree taxpayers had moved from Alaska to Oregon where their retirement income was then subject to Oregon's discriminatory tax. *Simpson v. Department of Revenue*, 12 Or. Tax 455 (Or. Tax Ct. 1993). This factual scenario bears absolutely no resemblance to this case where California has conducted its governmental operations in New Mexico for some fifty years. The Oregon tax court's analysis has no application here.

Nevada v. Hall was not a tax immunity case and did not involve a discriminatory state policy that would implicate the underlying purpose of the ITI doctrine. California's policy of unlimited tort exposure challenged in that case by the State of Nevada was ***equally*** applicable to the State of California. California's willingness to

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> immunity caselaw does not leave States unprotected from excessive federal taxation – *it merely recognizes that the best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion.* For where a government imposes a nondiscriminatory tax, judges can term the tax "excessive" only by second guessing the extent to which the taxing government and its people have taxed themselves, and *the threat of destroying another government can be realized only if the taxing government is willing to impose taxes that will also destroy itself or its constituents.*

485 U.S. at 525, n. 15. (Emphasis supplied).

impose an equal obligation upon itself provided the requisite political check and balance required under ITI doctrinal analysis to safeguard the governmental functions of other states from excessive or undue impairment. That nondiscrimination safeguard is prominently absent in this case.

No issue of discriminatory state policies or intergovernmental tax immunity was presented in *State of Georgia v. City of Chattanooga*, 264 U.S. 472, 44 S.Ct. 369, 68 L.Ed. 796 (1924). Likewise, *Bonaparte v. Tax Court*, 104 U.S. 592, 26 L.Ed. 845 (1881) holds only that debtor states cannot exempt their registered public debt from taxation in another state. The decision neither discusses discriminatory taxation nor the ITI doctrine.

The early state court decisions cited by the Respondent likewise present no solution to the questions presented in the Petition for Writ of *Certiorari*. None address the ITI doctrine or the constitutional purposes for which the doctrine was fashioned in the decisions of this Court. *Warren County, Mississippi v. Hester*, 54 So.2d 12 (La. 1951) rejected an equal protection argument concerning the application to the state of Mississippi of a "public property" exemption in Louisiana's constitution. *Minnesota v. City of Hudson*, 42 N.W. 2d 546 (Minn. 1950) holds only that a Wisconsin municipality receives protection from the State of Minnesota and must therefore pay tax on its holdings in Minnesota. The broad proposition in *Kansas v. Holcomb*, 116 P. 251 (Kan. 1911) that a state brings none of the prerogatives of sovereignty with it when it engages in activities in another state, is the same sweeping proposition this Court declined to adopt in *Nevada v. Hall*. See *ante* at page 3, footnote 3.

In short, unlike any of the cited cases, the case at bar ***squarely*** presents the constitutional problem that results from a ***discriminatory*** state tax upon the governmental operations of another sovereign state. This is the appropriate case for determining whether and to what extent

the Constitution requires application of the ITI doctrine among the sovereign states.

RESPONSE TO POINT TWO

Petitioners' alternative claim in the court below was that the New Mexico tax is also constitutionally invalid because it discriminates against those who deal with the federal government. As it does with its own retirees, the federal government funds the employer portion of the Petitioners' retirement benefits through the direct funding provisions of the US/UC Contract. (Appendix F, App. 28-29, ¶s 4, 6 and 8). Ordinarily, the fact that the federal government bears the economic burden of a tax on its contractors through this type of cost pass-through provision does not implicate the ITI doctrine because the legal incidence of the tax does not fall on the federal government. *United States v. New Mexico,* 455 U.S. 720, 102 S.Ct. 1373, 71 L.Ed.2d 580 (1982); *U.S. v. California,* ___ U.S. ___, 113 S.Ct. 1784, 123 L.Ed.2d 528 (1993).

In this case, however, we are dealing with a discriminatory tax and different principles apply under the ITI doctrine. This Court has recognized that where the ***economic burden*** of a discriminatory tax falls upon the federal government, the tax violates the ITI doctrine even though the legal incidence of the tax does not fall upon the government itself. *South Carolina v. Baker,* 485 U.S. at 523 (states can tax private parties doing business with the federal government even though the economic burden falls on the United States so long as the tax does not discriminate against the United States or those with whom it deals).

Respondent claims the ITI doctrine only applies to a tax which discriminates against taxpayers because of their dealings with the federal government. (Brief in Opposition, at 10-11). To the contrary, this Court's decision in *Davis v. Michigan* demonstrates that it is the ***economic burden*** of the discriminatory tax upon the federal government that determines its validity under the ITI

doctrine, not the nature of the contractual relationship between the taxpayer and the federal government.

The discriminatory tax struck down in *Davis* was not directed at the contractual relationship between the federal government and its retirees any more than it was aimed at retirees of resident or foreign corporations or retirees of large or small businesses. The discriminatory tax was aimed at reducing Michigan's own employment costs by exempting the retirement income paid to its own governmental retirees. Because the tax discriminated against retirees who were paid from the federal treasury, it violated the ITI doctrine. *Davis*, 489 U.S. at 815, n. 4 (taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation the ITI doctrine was intended to bar). That the tax also discriminated against the vast majority of other retirees in the state was found to be immaterial by this Court. *Davis*, 489 U.S. at 815, n. 4.

As applied to the Petitioners retirement income, New Mexico's discriminatory tax places the same type of economic burden upon the federal treasury described in *Davis*, because the federal government, as with its own retirees, directly funded the retirement income of the Petitioners through the segregated bank account specifically provided for in the UC/US Contract. (See Appendix F, App. 34-35, ¶s 8-10). Under this Court's economic analysis in *Davis*, New Mexico's discriminatory tax must also be held to violate the ITI doctrine.

The New Mexico Court of Appeals rejected this claim because the legal incidence of the discriminatory tax did not fall upon the federal government. Neither did the legal incidence of the discriminatory tax in *Davis* fall upon the federal government. Because the decision of the lower court conflicts with *Davis* and other decisions of

this court applying an economic analysis to ***discriminatory*** taxation, this Court should review the lower court's analysis and application of the ITI doctrine.

Respectfully submitted,

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